GOVERNMENT CONTROL OF BANKS AND TRUST COMPANIES

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The passage of the National Bank Act, or National Currency Act as it was first called, may be considered the beginning of the federal control of banks. This has now been exercised for more than forty years with most satisfactory results, both to the government, the banks and the people who have done business with them. It has resulted in an excellent system of banks, honestly, ably and well managed. The figures in regard to the number of failures and loss to depositors which are given elsewhere in the article show an unequalled record of soundness and safety, and, contrasted with the previous records of State banks and even with the better and stronger State banks and trust companies which have existed alongside of the national banks, make a strong argument in favor of national control of institutions of this character. The total loss in over forty years is less than eight one-hundredths of one per cent. of the average amount on deposit. The volume of experience gained during the forty years' control of the national banks is probably the greatest accumulation of such experience which has ever been made, based, as it is, upon the control of a greater number of banks, more widely distributed, doing a larger volume and variety of business and covering a longer period than has ever been exercised in any other country. As a matter of fact, other countries do not attempt such a complete control or examination of banks as we do in the United States. The nearest approach to our national system is in some of our State bank departments. State banks, and especially the mutual savings banks in several States, are quite closely controlled in their management by specific statutes and are frequently and thoroughly examined. But there is no other system of banks over which there has been for any such period such a thorough control through restrictive statutes, frequent examinations and reports, as has been exerted over the national banks of the United States.

Probably the main consideration in the passage of the currency act establishing the system of national banks was to provide a market for the national loans made necessary by the war. The country, however, was glad of a chance to exchange the system of State banks under different laws in each commonwealth for a national system, which would at least be uniform, and which, above all, would substitute a system of national bank note currency for the many issues of State bank notes. As is well known, it was then expected that this bank note currency would replace all other forms of paper currency in circulation. It was probably on this account that the official who was to have charge of the relations of the federal government and the banks, was called Comptroller of the Currency, instead of the Comptroller or Superintendent of National Banks, which, as events have shown, would be a more distinctive title. The issue of legal tender, United States notes and other forms in circulation, and later the addition of a large volume of silver certificates to our paper circulation, have made such a change in the situation that, instead of furnishing all the paper currency, the national bank notes have formed but a comparatively small part of it.

It was mainly the granting of the privilege of note circulation which first attracted banks to the national system and made any national control of banks possible. The national banks were intended and expected to be primarily banks of issue, and were indirectly given a monopoly of this privilege by a prohibitive tax levied on the issues of all other banks. Outside of their note issues, the powers of the national banks were quite severely restricted. They were expected to be banks of deposit and discount and to transact, as far as possible, the local commercial business of their community. They were denied the power to have branches, to make loans on real estate or to own real estate other than their necessary banking houses, to loan more than ten per cent. of their capital to any one person, firm or corporation, to own or deal in shares of stock, to own or make loans on their own shares of stock as security. Each bank was originally required to keep a minimum reserve against deposits and notes issued, but this was later amended to require a reserve on deposits only.

When the act was first passed, there was much question whether the inducements offered the banks were sufficient to induce them to

submit to examination, restriction and control by the United States. Many of the early banks were organized, or converted from State to national as much or more from patriotic motives as from hopes of increased profits. The fact is, the circulation has never been very profitable; never sufficiently so to induce the banks to approach the maximum amount permissible. The highest percentage of possible circulation was issued in 1882 and was 81.6 per cent. This gradually declined to 27.54 per cent. in 1892 and has since then steadily increased to 54.75 per cent. in 1903. A strong inducement to the banks in the larger cities to secure national charters is the system of reserve and central reserve banks, which permits a national bank in other cities to keep two-thirds of its cash reserve on deposit with an approved reserve agent national bank in a reserve or central reserve city; and a bank in a reserve city to keep one-half its reserve in the central reserve cities St. Louis, Chicago and New York. This gives national banks in reserve cities an opportunity to secure large deposits from country banks which the State banks cannot secure, because deposits with State banks are not counted as reserve, and are also subject to the ten per cent. limit on indebtedness by any one firm or corporation. An additional inducement for banks to submit to federal control is the greater confidence in which the banks under national supervision and control are held by the people. This has steadily increased since the creation of the system as the result of the examinations and published reports, and that this is justified is shown by the comparative statement of the failures of national and State banks. From the date of the organization of the national system to January 22, 1904, there were organized 7083 national banks. Of this number 404 became insolvent and 1499 have gone into voluntary liquidation, leaving 5180 in operation. The percentage of failed banks to the total organizations is 5.7 per cent.; the percentage of liquidating banks is 21.2.; the percentage of active banks is 73.1.

From an estimate based on 330 insolvent national banks whose affairs have been finally closed, dividends amounting to 71.31 per cent. have been paid on claims proved amounting to $101,724,840. Including in this estimate, however, offsets allowed, loans paid, etc., the creditors received on an average 78.55 per cent. on their claims. This would make a loss of 21.45 per cent. to the creditors. The total

loss to depositors in forty-one years on deposits, now amounting to almost three and one-half billion dollars, has been less than thirty million dollars. The cost of liquidation, based on the total amount collected from assets and from assessment on shareholders was $8,579,822, or 8.3 per cent. The causes of failure have been classified as follows:

Excessive loans	22.81%
Fraudulent management and defalcation	36.34%
Injudicious banking	25.06%
General stringency and panic	15.79%

Comparing the result of failures and liquidations among the national banks with the figures in regard to the failures of State banks from 1863 to 1896, as given in the report of the Comptroller of the Currency for 1896, the last date to which complete figures are available, it will be seen that while only 6.5 per cent. of the number of national banks in existence failed during this time, 17.6 per cent. of the other banks in existence failed. And while the national banks which had failed up to 1896 paid to their creditors 75 per cent. in dividends, the State and other banks paid only about 45 per cent. The cost of liquidation of State and other banks which failed is also very much higher than the cost of liquidation of national banks.

The present law authorizes the Comptroller to order an examination of a bank at any time he may see fit. For several years after the establishment of the system but one examination was made each year. After a short time the banks in the reserve cities were examined twice in each year. During the administration of Mr. Eckels after the panic of 1893, this system was extended until each bank is now examined regularly twice each year. The reports made by the examiners have grown from a short statement of liabilities and resources until they now cover all vital points of interest in regard to the condition and solvency of the bank examined. These reports when received in Washington, are gone over very carefully by a corps of trained men, and letters are written to the banks, calling attention to and criticising the various items in the reports and asking for an explanation or additional information in regard to them. This is probably the most important work of the Bureau, especially in cases where a bank is in a critical condition. Probably the greatest utility which is done by the Currency Bureau is to be seen in those cases where it is

discovered, through the reports, that a bank has made such losses as to involve an impairment of capital or possible insolvency. In more cases than are generally known the Comptroller of the Currency, with the aid of the bank examiner, is able to save a bank which, without intervention and assistance, would have failed. Of course it is essential to success in this matter that secrecy be observed, and it rarely becomes known to anyone outside of the bank and the Comptroller's office what has been the condition of a bank or what steps are necessary to save it. It is the experience of the office that, where the officers of the bank are honest, truthful and make complete statements of their difficulties, in most cases additional security can be obtained for doubtful paper, or such a contribution made by the directors or other stockholders that the impairment of capital or insolvency can be entirely removed, and there are many banks in the United States to-day which have been saved in this way and are now not only thoroughly solvent, but highly prosperous institutions. This system of examinations, of course, is far from perfect. The examiner cannot, in the time at his disposal, make such an inspection as will always result in the detection of fraud and violations of law. If the officers of a bank, or any of them, are dishonest, being in the bank every day, they have every advantage over an examiner, and are very frequently able to deceive him. No system of examination can supply ability or ensure honesty in bank management. This must be supplied by the officers and directors, and upon them the responsibility must rest. In any well managed bank the work of the examiner ought to be supplemented and aided by continued and thorough examinations by the directors themselves, or someone appointed by them independently of the men who regularly have charge of the funds and accounts. In addition to the two examinations in each year, each national bank is compelled by law to make to the Comptroller at least five sworn reports of its condition. These were first made on fixed dates, but it was found that as these dates were known the banks would always prepare to make their statement; and the present method is for the Comptroller to call for a statement of condition as of some previous date, and these are always made without any notice to the bank on dates which are not fixed by the Comptroller until the moment the call is made. A summary of the statement of condition of all banks of the country, divided by States,

which is published within two or three weeks after the issuance of a call, gives very prompt and valuable information as to the condition of the banks in all parts of the United States.

It is worthy of notice that, while the national banking system has been steadily growing until there are now about 5200 banks, with the great resources already referred to, the tendency to increase, both in number of banks, capital and deposits is greater among the banks other than national than among the national banks. The following is a table from the report of the Comptroller of the Currency for the year 1903:

BANKS.	Number	CAPITAL.		DEPOSITS.	
		Amount.	Per cent.	Amount.	Per cent.
1882.					
National	2,239	$477,200,000	67.01	$1,131,700,000	39.7
State, etc	5,063	234,900,000	32.99	1,718,700,000	60.3
Total	7,302	712,100,000	100.00	2,850,400,000	100.00
1892.					
National	3,759	684,678,203	63.9	1,767,519,745	37.8
State, etc	5,579	386,394,845	36.1	2,911,594,571	62.2
Total	9,338	1,071,073,048	100.00	4,679,114,316	100.00
1902.					
National	4,535	701,990,554	52.4	3,222,841,898	33.2
State, etc	7,889	499,621,208	47.6	6,005,847,214	66.8
Reporting for tax only	3,732	138,548,654		478,592,792	
Total	16,156	1,340,160,416	100.00	9,707,281,904	100.00
1903.					
National	4,939	743,506,048	50.43	3,348,095,992	32.81
State, etc	8,745	578,418,944	49.57	6,352,700,055	67.19
Nonreporting	4,546	152,403,520		502,522,431	
Total	18,230	1,474,328,512	100.00	10,203,318,478	100.00

The national banks, which had 67 per cent. of the capital in 1882, had 63.9 per cent. in 1892, 52.4 per cent. in 1902 and 50.43 per cent. in 1903. The national bank deposits, which were 39.7 per cent. of the whole in 1882, were 37.8 per cent. in 1892, 32.2 per cent. in 1902 and 32.8 in 1903. Some of this apparent decrease may be possibly due to more complete returns from the banks other than national which are now obtained, but there is no doubt of the fact that the tendency is for the banks other than national to increase more rapidly. This is true in spite of the fact that the law of March 14, 1900, authorizing the organization of national banks with a capital as low as

$25,000, has resulted in the conversion of a large number of State banks in the country towns into national banks, and the organization of a great many national banks to succeed private ones. Probably the principal reason for this tendency is the great increase in the number of trust companies which have been organized during the last ten years. These companies, organized under State laws originally designed to provide for companies doing a strictly trust business are taking advantage of the liberal character of those laws, and a very large portion of the new organizations are merely commercial banks, having trust company privileges perhaps, but in reality doing comparatively little strictly trust company business. The laws of the different States, particularly in regard to the cash reserves to be held, and loaning money on real estate security, are so liberal that organizations of this character have a great advantage over the national banks in the inducements which they can offer their customers. It is naturally to be supposed that any one contemplating the organization of a new bank, other things being equal, will be inclined to do so under the laws which allow the greatest freedom from governmental interference, restriction and control. The question as to what shall be done in the way of control of these new trust companies is very important. It would be a great mistake for the different States to allow the national banking system to be broken down or seriously weakened by new organizations which are able to do so because they are less carefully examined and controlled than the national banks. The national system has furnished most excellent banks for the regular commercial banking business. It is not likely to be an improvement to have this replaced by any system of State banks. Much less is this likely to be the case if the inducement to go into the State systems is greater freedom from control, weaker reserves and less careful management. The modern trust company has been called the highest example of modern commercial organization, and of many of the largest and best companies this is doubtless true. The regular trust company business is a very important part of any financial system, and calls for the highest degree of character, honor and ability.

I quote from a recent writer on this subject, and agree with all that he has said in regard to the trust companies:

"Trust companies are formed for the execution of the most

sacred duties that can be imposed by man. The care of the property and welfare of the helpless and the dependent, the widow and the orphan, the feeble and ignorant ones, who are such an easy prey for the unscrupulous, is part of their mission; to carry out the wishes of the dead, who put faith in the company and entrusted their dearest interests to it for years in the belief that it always would be true and honest; to meet the expectations of the living, who entrust their property to it in full confidence that it always will be faithful and capable; this demands a conscientiousness and thoroughness, which must always serve as a high ideal and inspiring stimulus to right-minded men."

When, however, the trust companies cease to do this character of business or attempt to add to it not only ordinary commercial banking, but in many cases underwriting and promotion of all sorts of new enterprises, the case becomes entirely different. It can hardly be said to be a reasonable or proper regulation of the banking and trust company business to allow the organization, under the same law, of concerns which not only have the power to act as trustees in all of the important capacities which the writer has enumerated, but which also have the power, if the management is so inclined, to do a general commercial banking business with little or no cash reserve, and even to underwrite an issue of bonds and securities several times in value the combined capital, surplus and deposits of the so-called trust company, as happened in a recent notable case. In another instance trust companies organized under the laws of certain Eastern States engaged in the organization of national and other banks in the Western States and attempted to pay up the capital with certificates of deposit in the so-called trust company. It is true most of the older trust companies have been splendidly managed in every respect, their officers and directors are men of the highest character who can safely be trusted with any business, whether it is in the nature of a trust, commercial banking, promotion, or underwriting. It is not such concerns as this which need control and regulation. Their business will be well and properly done in any event, and probably will come well within the terms of any law intended to control this class of business. Such concerns as this have nothing to fear from regulation, nor should they oppose the attempts to place reasonable safeguards upon the business for the protection, not only of their

depositors and creditors, but of the entire country. If there is any reason why a national bank should maintain reserves against commercial deposits, the same reason will apply to commercial accounts in any other bank, whether called a trust company or not. A trust company with a large business in its trust department, if it also has a banking or savings department, owes it to its customers and to the public to see that the banking department is not so conducted as to endanger its trusts in the slightest degree. The very existence of those trust obligations should make its banking department ultra-conservative and careful, as so many of them are. The trust company, whose chief business is in its banking and savings department and is carefully and conservatively managed, is more interested than anyone else to prevent reckless and incompetent, or dishonest, men from securing similar charters which will permit them to run competing banks, without proper reserves or other safeguards prescribed by experience. Frederick D. Kilburn, Superintendent of the New York State Banking Department, says in regard to reserves in Trust Companies for March, 1904:

"After mature consideration of the subject and a study of the existing conditions, I am of the opinion that the whole matter should be regulated by statute. Before this is attempted, however, the banks and the trust companies should agree upon the provisions of any proposed legislation in this direction. All feelings of spite and selfishness, if any exist, should be forgotten. The interests of any particular institution, except as it may be in harmony with the interests of all, should not be considered. The law should be general in terms, and, if any class of deposits are exempted from its operation, sound reasons should be given for the exemption.

"I am well aware that many trust company officials, and some bank officials, will not agree with my view. Some think, and perhaps not without reason, that they are able safely and conservatively to conduct the affairs of their institutions without interference of this or any other kind; but others will sometime take their places, and then perhaps a less experienced and less conservative management will be in control. The whole matter should be adjusted with exclusive regard for the needs of the situation, and with the sole purpose of conserving the interests of all concerned. In the meantime, it should be remembered that trust companies and banks alike are

in the main founded upon the same general principles and are dependent to the same degree upon public confidence for success."

In his annual report for 1904, Mr. Kilburn also says:

"The right of domestic trust companies to hold stocks in private corporations might wisely be definitely defined, their right to engage in underwriting schemes unqualifiedly denied, and the obligation imposed upon them to carry a legal reserve. As a part of this latter proposition, I am confident that it would be advisable to require also that these institutions and the State banks in New York make weekly reports similar in scope to those submitted by the Clearing House banks and the non-member banks to the Clearing House Association."

Whatever regulation or control there is to be of the trust companies must come, for the present at least, from the State governments. Federal control of the national banks has been so satisfactory and successful that there is some desire expressed for federal control of other banks and trust companies. There has not been, however, so far as I know, any practical suggestion made by which these institutions can be forced or persuaded to submit to Federal control, especially if it is to be more severe than that now exercised by the States. Federal control, therefore, does not seem to me to be a present practical question.

Do not misunderstand this as in any degree an attack on the trust companies or as unjust criticism of them by a partisan of national banks. The trust companies can have no better friend than I am. I believe in them thoroughly; I recognize the great value of their past services and their possibilities for good in the development of our country in the future. There is abundant field and scope for both the national banks and trust companies, but they should work in harmony, aiding and supplementing each other. I speak in the interests of both, and in advocating more careful control and conservative management, I do so in the interest of the many splendid banks of both kinds whose able, honest, conservative management, with or without restrictive laws, is entitled to the protection which only such laws can give them against not only the competition but the danger to their institutions and the whole country which may come from institutions whose management is in less honest and less able hands.